EC-C-1999-040

OSWER # 9835.6

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY

(5)

NOV 17 1988

MEMORANDUM

SUBJECT: Guidance on Premium Payments in CERCLA Settlements

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TO: Regional Administrators
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I. BACKGROUND AND PURPOSE

Attempts to reach settlements under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), 42 U.S.C. §§9601 et seq., as amended by the Superfund Amendments and Reauthorization Act (SARA) of 1986, Pub. L. No. 99-499, pose difficult problems for both the regulated community and the Agency. Potentially responsible parties (PRPs) are often reluctant to settle hazardous waste enforcement cases because future cleanup costs are unknown; they seek broad covenants not to sue in an effort to provide a final determination of the extent of their liability. EPA, on the other hand, is reluctant to assume the risk that further site remediation will be required following

completion of the work contemplated in the settlement agreement or that the cost estimate is inaccurate.

One way to address these obstacles to settlement is for EPA to require, in appropriate situations, a "premium payment" from PRPs in exchange for the Agency assuming future remediation and financial risks. The term "premium payment" refers to a risk apportionment device, similar to an insurance premium, under which the risk taken by the government for providing PRPs with a release from liability not usually available (e.g., a covenant not to sue without the usual "reopeners" or a covenant not to sue for certain types of cost overruns) is offset by a payment in excess of the cost projected to complete the remedy. The premium should be sufficient to compensate EPA for taking the risks associated with the following types of contingent future costs: (1) cost overruns when the selected remedy costs more to complete than estimated; and (2) additional costs when more remedial work is required because the selected remedy is not adequately protective of human health and the environment.[1]

The purpose of this memorandum is to provide guidance on the use of premium payments in CERCLA settlements. It

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[1] As discussed in Section IV, infra, "Timing of Premium Payment Settlements," premium payment settlements will not usually occur until after the remedy has been selected. Thus, the permanence of the remedy chosen will not be affected by the existence of a premium payment and such settlements are not considered to be inconsistent with Section 122(c)(1) of CERCLA.

describes the key features of a premium payment settlement, considerations regarding timing of the settlement, and the factors to be considered in deciding if a premium should be accepted. Settlements with de minimis parties, as authorized by Section 122(g)(1)(A) of CERCLA, will usually include a premium payment if the de minimis parties seek a complete release from future liability. Use of premium payments in such settlements is discussed in the Agency's "Interim Guidance on Settlements with De Minimis Waste Contributors under Section 122(g) of SARA," 52 Fed. Reg. 24333 (June 30, 1987).

II. THE PREMIUM PAYMENT CONCEPT

A. Premiums Designed to Address Future Liability

Section 122(f)(1) of CERCLA authorizes EPA in certain circumstances to provide to PRPs covenants not to sue for liability, including future liability, resulting from a release or a threatened release of a hazardous substance addressed by a remedial action.[2] Typically, settlements[3] in which PRPs reimburse EPA for past costs and future oversight costs and undertake performance of the remedy include covenants not to sue for past costs and for present

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[2] This authority is discretionary, but in two circumstances, specified in Section 122(f)(2), EPA must grant a covenant not to sue for future liability if the PRP qualifies under Section 122(f)(1).

[3] SARA adopted in large part guidance on settlements set forth in the Agency's "Interim CERCLA Settlement Policy," 50 Fed. Reg. 5034 (Feb. 5, 1985).

liabilities (e.g., construction of the remedy). They may also include covenants not to sue for future liability,[4] usually with certain exceptions (i.e., reopeners). Under Section 122(f)(3), covenants not to sue for future liability may not take effect until EPA certifies that the remedial action is complete.

As to future liability, Section 122(f)(6) provides that in most situations, a covenant not to sue for future liability must include a "reopener" that allows EPA to pursue the settling PRPs concerning conditions that were unknown at the time EPA certified that the remedial action was complete. Agency policy also requires that settlements include a reopener to the covenant for future liability where new information reveals that the remedy is not protective of human health and the environment.[5]

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[4] In Section 122(f)(1) of CERCLA, Congress authorizes EPA to issue covenants not to sue for both present liability and future liability. In the context of covenants not to sue involving remedial action, "EPA interprets present liability as a responsible party's obligation to pay those response costs already incurred by the United States related to a site and to complete those remedial activities set forth in the Record of Decision for that site. Future liability refers to a responsible party's obligation to perform any additional response activities at the site which are necessary to protect public health and the environment." See EPA's "Interim Guidance on Covenants Not to Sue Under Section 122(f) of SARA," 52 Fed. Reg. 28038, 28040 (July 27, 1987).

[5] Id.

Under Section 122(f)(6), the Agency may exclude the "unknown conditions" reopener from the covenant not to sue for future liability if EPA determines that "extraordinary circumstances" exist.[6] For purposes of this memorandum, the "unknown conditions" and the "new information" reopeners will be treated together. In determining whether extraordinary circumstances exist, each case should be evaluated using the various factors specified in Section

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[6] However, under Section 122(f)(6)(B), even if extraordinary circumstances exist, the unknown conditions reopener may not be waived if the settlement does not otherwise provide reasonable assurance that public health and the environment will be protected from any future releases.

122(f)(6)(B).[7] The premium payment itself should be considered in the analysis as well.

If extraordinary circumstances exist, the Agency may waive the reopeners to the covenant not to sue for future liability in a premium payment settlement. Given the broad scope of the factors to be evaluated, the inclusion of a premium payment in a settlement cannot be the sole, or even the predominant, determinant of extraordinary circumstances. The presence of a premium should be one of several factors which, when taken together, lead the Agency to conclude that

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[7] Section 122(f)(6) refers to both the factors specified in Section 122(f)(4) and additional factors that reiterate the guidance set forth in the Interim CERCLA Settlement Policy. The additional factors relate to the volume and character of the substances at the site; to risks associated with the strength of the government's case on liability, ability to pay, precedential value, and inequities and aggravating considerations; and also to public interest considerations. The factors specified in Section 122(f)(4) relate primarily to the nature of the remedy. They include:

a. The effectiveness and reliability of the remedy, in light of the other alternative remedies considered for the facility concerned.

b. The nature of the risks remaining at the facility.

c. The extent to which performance standards are included in the order or decree.

d. The extent to which the response action provides a complete remedy for the facility, including a reduction in the hazardous nature of the substances at the facility.

e. The extent to which the technology used in the response action is demonstrated to be effective.

f. Whether the Superfund or other sources of funding would be available for any additional remedial actions that might eventually be necessary at the facility.

g. Whether the remedial action will be carried out, in whole or in significant part, by the responsible parties themselves.

What constitutes extraordinary circumstances must be based on the facts of each case.

the circumstances and terms of the settlement warrant the granting of a covenant not to sue without reopeners.[8]

B. Premiums Designed to Address Cost Overruns

In a settlement in which the PRPs agree to reimburse the government for cleanup costs associated with present liability, the issue of how to calculate as yet uncertain costs associated with the anticipated remedy must be addressed. Generally, the government desires that PRPs finance all response costs, and thus PRPs must await the completion of the remedial action before the extent of their present liability is established. However, if the PRPs would prefer to firmly establish the "price tag" for present liability before cleanup is completed, one option is to require PRPs to provide funds believed to be sufficient to cover projected cleanup costs, plus a premium to protect against cost overruns. Although the government as a matter of course seeks to avoid assuming risks associated with the uncertainties of cost projections, the payment of appropriate cost overrun premiums should ensure that, viewing the cost recovery program as a whole, the government is protected against those uncertainties. Settlements which include a premium for present liability, including cost

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[8] In certain situations, EPA may reach settlements where extraordinary circumstances exist without requiring a premium payment. For example, EPA may exclude the unknown conditions reopener without a premium payment in a settlement with a PRP who has invoked the protection of Chapter 7 bankruptcy laws.

overruns premiums, may be appropriate, but the traditional reopeners would be applied to future liability in such settlements.

III. AMOUNT OF THE PREMIUM PAYMENT

As noted above, premium payments may serve two purposes -- to provide funds to protect public health and the environment in the event that additional response work will be needed at the site or to protect against the risk that site remediation cost overruns may occur. In evaluating the offer, EPA must determine whether the amount of the premium is adequate given the risks assumed. The factors specified in Sections 122(f)(4) and 122(f)(6) of CERCLA, used to determine if extraordinary circumstances exist, should also be considered in determining the amount of the premium payment. The factors specified in Section 122(f)(4) that relate to the effectiveness, reliability, and permanence of the remedy are particularly important in determining the likelihood that additional response work may be necessary and the associated possible costs.

A. Future Liability Premiums

Despite best efforts by the Agency or PRPs to design and implement a satisfactory remedy, future problems may arise at the site due to remedy failure or mistaken assumptions about the effectiveness of the remedy. In addition, the discovery of new information about site conditions or new scientific determinations regarding what

levels of contaminants present a risk to humans or to the environment may make additional work necessary. One way such new information may become available is through the Section 121(c) five year review EPA is required to conduct for all remedial actions at sites where hazardous substances remain.

In determining the amount of a "future liability" premium, two general factors should be considered: the likelihood that future remediation will be required and the cost of such remediation. The resulting premium could be a percentage of the total estimated cost of the remedy.

1. The likelihood that further remediation will be required: The need for further work may depend on the effectiveness and reliability of the remedy. Factors such as whether the remedy selected has been demonstrated to be effective under similar conditions at other sites, whether the remedy selected involves treatment or incineration as opposed to containment, whether the settlement agreement includes specified performance standards, or the extent to which the remedy provides a comprehensive solution to site contamination, all bear on the level of the premium.

The risk that further work will be required also depends on the extent to which all relevant environmental conditions have been discovered and evaluated. For example, additional information about relevant conditions developed

during the remedial design phase may enhance the Agency's confidence in the selected remedy.

In addition, the time necessary to complete the remedy may affect the risk of further contamination occurring. For example, if a long period of temporary storage will precede disposal or treatment, the premium should be calculated so as to protect against releases during storage.

2. The cost of further remediation: Any premium payment must be based in part on an estimate of the cost of conducting additional remedial work should the chosen remedy fail to abate the hazards posed by the site. EPA's estimate should be based on a site-specific estimate of the most probable costs of the additional response action. Where the estimated cost of replacing, repairing, or otherwise supplementing the remedy is very high, the government should either retain the right to pursue the settling PRPs for additional work or costs, or require a premium payment commensurate with the cost and the risk that future remediation will be necessary.

B. Cost Overrun Premiums

The Agency also recognizes the possibility that a selected remedial action will cost more than originally estimated because, for example, (1) the cost estimate was inaccurate or (2) estimates concerning the amount or type of material to be treated or the length of time for treatment

were inaccurate.[9] EPA can guard against these cost overruns by reserving the right to seek reimbursement for any overruns or by requiring an up-front payment of a "cost overruns" premium. The amount of the premium should be based on the reliability of the Agency's cost estimate, taking into account such factors as the length of time needed to complete the remedy and any historical data on instances where actual costs of site remediation exceeded projected costs. The premium could be a percentage of the estimated cost of the remedy based on the risk of such cost overruns.

C. Settlement Amount

In determining the total settlement amount, the premium payment must be added to the total response costs. This base amount to which the premium is added should include past costs, indirect costs, prejudgment interest, the estimated cost of the remedy (unless performed by PRPs), oversight costs, operation and maintenance costs, and technical assistance grants. The total settlement amount would be the base amount plus the premium. Generally, the settlement agreement should specify which portion of the premium payment is allocated to present liability and which portion to future liability.

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[9] If estimates concerning the amount or type of material to be treated were inaccurate because of unknown conditions or new information, the resulting additional costs would be considered part of the responsible party's future liability.

IV. TIMING OF PREMIUM PAYMENT SETTLEMENTS

The Agency usually should not consider a premium payment settlement unless it has adequate information about the identity, waste contributions, and viability of PRPs for the site concerned, and about the costs of remediating site contamination. The Agency develops information about PRPs through PRP searches, the remedial investigation and feasibility study (RI/FS), and information-gathering activities under Sections 104(e) and 122(e) of CERCLA and Section 3007 of the Resource Conservation and Recovery Act. A Nonbinding Preliminary Allocation of Responsibility (NBAR), authorized by Section 122(e)(3) of CERCLA, if prepared, may also provide significant information for evaluating a premium payment settlement.[10]

Premium payment settlements should not be pursued until the Agency is able to determine the likely remedial action and estimate, with a reasonable degree of confidence, the total cost of cleaning up the site, including oversight and operation and maintenance. The Agency usually will arrive at this level of confidence only after the RI/FS and a

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[10] See, EPA's "Interim Guidelines for Preparing Nonbinding Preliminary Allocations of Responsibility (NBAR)," 52 Fed. Reg. 19919 (May 28, 1987). Section 122(e)(3) of CERCLA authorizes EPA, at its discretion, to prepare an NBAR which allocates 100 percent of response costs among PRPs in order to promote and expedite settlements.

Record of Decision (ROD) have been completed.[11] A premium payment settlement could be considered earlier if the Agency is relatively confident of its ability to estimate future response costs, and the premium payment amount reflects the increased level of uncertainty.[12]

V. USE OF THE PREMIUM

Normally, premium payments will be made to the Hazardous Substances Superfund. The Agency is exploring the circumstances under which it may be appropriate for settling PRPs to establish site-specific trust fund or escrow accounts. Further guidance on this issue will be provided by separate memorandum.

If the costs of the remedy exceed the recovery from settling PRPs (including the premium), EPA will generally seek to recover remaining costs from other PRPs. The Agency may also approve comprehensive settlements in which certain PRPs pay a premium to other PRPs who, in exchange, agree to accept the responsibility of those premium-paying PRPs regarding site liability, including any possible future liability.

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[11] Timing considerations for settlements with de minimis PRPs are discussed in greater detail in EPA's "Interim Guidance on Settlements with De Minimis Waste Contributors Under Section 122(g) of SARA," 52 Fed. Reg. 24333 (June 30, 1987).

[12] Early premium payment settlements may also be appropriate in exceptional cases, such as where bankruptcy exists.

Normally, both the base amount and the premium will reduce the government's claim for costs associated with performance of the remedy. However, in settlements involving a premium for future liability, EPA may segregate the portion of the premium paid for future liability. In certain cases, EPA may determine that it is appropriate to require PRPs to set aside the premium in a site-specific account established by the PRPs for use if the remedy fails. If such an account is established, future liability premiums would not reduce the amount owed by subsequent settlors or non-settlors for present liability (i.e., the present remedy). Rather, premiums for future liability will only reduce subsequent settlors' or non-settlors' future liability when and if additional cleanup is required to protect public health or the environment. Until then, the government will not have accepted the premium payment.[13]

Premium payments may be particularly useful in mixed funding or mixed work situations. For example, EPA may require a premium payment from PRPs to protect against cost overruns and remedy failure for EPA's portion of the work in a mixed funding or mixed work site.[14]

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[13] The settlement agreement also should specify how the premium payment is to be distributed if it is not used for remedial activities.

[14] Where a de minimis settlement precedes a mixed funding agreement, any premium payment obtained from de minimis parties would reduce the share to be contributed by the Fund as part of the subsequent settlement.

VI. PURPOSES AND USE OF THIS MEMORANDUM

This memorandum and any internal procedures adopted for its implementation, are intended solely as guidance for employees of the U. S. Environmental Protection Agency. They do not constitute rulemaking or final action by the Agency and may not be relied upon to create a right or a benefit, substantive or procedural, enforceable at law or in equity, by any person. The Agency may take action at variance with this memorandum or its internal implementing procedures.